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Encouraging Private Business: Gorbachev's New Policies Off to a Slow Start [redacted] 25X1

An Intelligence Assessment

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Encouraging Private Business: Gorbachev's New Policies Off to a Slow Start

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An Intelligence Assessment

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Encouraging Private Business: Gorbachev's New Policies Off to a Slow Start

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Key Judgments

Information available as of 30 September 1987 was used in this report.

The Gorbachev regime has launched a cautious program encouraging the development of legal private businesses operated by individuals and small groups in an effort to satisfy consumer demand without large capital investments. New legislation has affirmed the legality of so-called individual labor activity and fostered the establishment of member-run cooperatives. Despite restrictions on eligibility to participate, the legislation reflects a willingness by the Soviet leadership to confront past economic orthodoxy and could lead to the most significant expansion of the legal private sector since Lenin's New Economic Policy of the 1920s.

The regime hopes that the new measures will alleviate "on the cheap" the shortfall in consumer goods and services without forcing major adjustments in resource allocation policy. By simultaneously cracking down on the flourishing underground economy, it hopes to persuade illegal businessmen to begin operating under state regulations intended to gain control of potentially lucrative income tax revenue and prevent excessive profits and misuse of state-owned property.

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The new measures are perhaps the regime's most controversial reform so far. Many party traditionalists fear that an expansion of the private sector will ultimately undermine political control. Conservative officials argue that expansion of the legal private sector will create additional opportunities for individual wealth that are incompatible with egalitarian socialist principles. Managers of farms and factories fear that the creation of potentially attractive opportunities in the private sector will lure away their workers.

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Thus far, despite certain advantages of the new program over previous legislation—such as a less onerous tax structure—the development of legal private business is proceeding more slowly than the leadership had hoped. It has given broad powers to local governments in implementing the new measures, but many of them have frustrated the efforts of those interested in undertaking such activity. Local officials, responsible primarily for the performance of state enterprises in their region, fear that private businesses will entice state employees away from their jobs and consume resources that could be used by state enterprises. The regime's program has also been slowed by the reluctance of citizens to get involved, because they fear Moscow will eventually reverse its policy, creating negative consequences for those who participate.

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The trouble-plagued beginning suggests that goods and services from legal private business in 1987 will account for only a tiny fraction of that provided by the state sector. Projections, based on the very limited data available, indicate that if the early pace continues, probably no more than 600,000 people—or roughly 0.4 percent of the labor force—will register to run their own businesses or join cooperative groups during 1987.

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In response to the slow start, the leadership appears to be stepping up its effort to encourage self-employment and cooperatives. Despite the reservations of some Politburo members, including "Second Secretary" Yegor Ligachev, other members have joined Gorbachev in publicly touting the new measures to expand legal private business. Several concrete steps are being taken that will address problems of implementation:

- A provision was added to the final version of the law on enterprises enacted by the Supreme Soviet calling on enterprises to assist self-employed individuals and cooperatives.
- Moscow is preparing a law on cooperatives probably intended to give greater legal underpinning to the cooperative movement and establish legal sanctions against authorities who obstruct it.
- The Ministry of Finance and its regional organs have been ordered to prepare a package of measures intended to facilitate the acquisition of credit by legal private businesses.

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For the leadership to overcome the slow start and reap the benefits it expects from cooperatives and self-employment, it will eventually have to loosen the restrictions on eligibility and provide people with additional incentives to become involved in such activities.

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In the meantime, the regime will probably use the Central Committee plenum's endorsement of the new program to hold regional officials accountable for obstruction and to follow through in introducing legislation intended to smooth implementation.

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Perhaps as important as persistently pushing the measures on cooperatives and self-employment will be the leadership's willingness and ability to clamp down more effectively on illegal operators. Such tactics fall short of the changes needed to make legal private economic activity flourish, but they would help build the credibility of the new measures among local authorities and the population and give Gorbachev and his allies leverage needed to push for further expansion of legal private business, which could effect considerable gains in consumer satisfaction.

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Scope Note

This assessment examines the purpose, content, and implications of legislation introduced by the Gorbachev regime to promote the development of the legal private sector.

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The Private Sector: Legal and Underground

Soviet authorities can only roughly gauge the size of the private sector, but their estimates indicate that the extent of legal activity is dwarfed by that of operators who do not register with the state or pay taxes. According to Ivan Gladkiy, Chairman of the State Committee on Labor and Social Problems, during 1986 there were 100,000 individuals engaged in legal self-employment. Such activity produced 0.1 percent of national income, according to an Izvestiya *article, and an even smaller percentage of gross national product. By contrast, Soviet economists Valeriy Rutgayzer and Vladimir Kostakov of the Gosplan Economics Scientific Research Institute estimate that, by the mid-1980s, 17 to 18 million people operated each year in the underground service sector at least part-time and their output was equivalent to that of 2 million full-time illegal operators. They estimate that illegal operators annually provide some 5-6 billion rubles of everyday services—from car repairs to tailoring. This suggests that the underground economy provides almost a third of all such services purchased by consumers. Soviet economist A. Shokhin, chief of a laboratory at the Central Economics Mathematics Institute, has estimated that, in cities, illegal operators perform 50 percent of footwear repairs, 45 percent of apartment repairs, 40 percent of automobile repairs, and 30 percent of household appliance repairs. In rural areas, illegal private activity plays an even more important role, providing as much as 80 percent of repairs of footwear, housing, and furniture.*

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Western surveys of Soviet emigres also point to how widespread and lucrative such illegal "second" economy activity is, at least among educated residents of urban centers in the European parts of the USSR. Surveys conducted by Israeli researcher Gur Ofur and American economist Gregory Grossman indicated that on average those households sampled earned from 461 rubles to 657 rubles a year from all private-sector work. The larger Soviet Interview Project (SIP), involving 2,800 emigres, arrived at a figure of 557 rubles a year. About 13 percent of the SIP sample engaged in private-sector activity. On average, private work absorbed 20 hours per month (the median), and it ranged from one hour to 450 hours per month. Private occupations were those that lent themselves naturally to moonlighting. About half were professionals; the other half were blue-collar workers, such as carpenters or garage mechanics. Earnings per hour on the "second" economy were on average eight times as great as on the official economy; for doctors, 42 times as great.

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Encouraging Private Business: Gorbachev's New Policies Off to a Slow Start

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The state sector of the Soviet economy has long been notorious for its inability to provide quality and convenience to consumers, leaving a gap that could potentially be filled by private businessmen. Ever since Stalin ended Lenin's New Economic Policy of the 1920s and built the "command" economy perpetuated by his successors, obstacles to such activity have been imposing. The Soviet constitution theoretically guarantees the right of citizens to engage in self-employment for private gain—in practice, however, it has provided scant protection against authorities geared to achieving economic gains through large state-owned and -operated enterprises, who have usually taken a hostile attitude toward private business. Moreover, until now there have been virtually no legal sources of supply from which private businessmen could obtain materials and equipment, and any earnings derived from legal private activities have been subject to a steeply progressive income tax.

Rather than attempt to cope with obstacles to operating legally, most enterprising individuals have chosen to operate underground. This unregulated "second economy" compensates for some of the state sector's inadequacy, but its growth over the years has been a source of concern for conservatives and reformers alike. Many believe that the illegal private sector hurts the economy more than it benefits it, and that large-scale theft and diversion of resources from state stores and enterprises serve only to line the pockets of underground entrepreneurs and the corrupt officials who assist them.

Controversial Proposals

Under the Gorbachev regime, reform-minded Soviet economists and officials have challenged ideological orthodoxy with proposals to expand legal private business.[2] Often legitimizing their proposals by citing the successful experience of Hungary and East Germany, they have argued that the development of legal private business will bring several benefits to the socialist economy:

- A legal private sector could respond more rapidly and flexibly to consumers' demands for goods and services of higher quality and greater variety than the state sector now provides.
- Such improvements could be made without major adjustments in the regime's allocation of scarce resources.
- Many businessmen now operating illegally in a burgeoning "second" economy could be encouraged to register with the government, allowing their income to be taxed and their activity regulated.

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- The regime could have another way—along with the introduction of comprehensive economic reforms in the state sector—to tap individual initiative and harness it to the benefit of the state.
- The regime could better mobilize labor not employed by the state, such as homemakers, students, and pensioners, at a time when the economy faces a labor shortage.
- Competition from private business would end the monopoly situation that allows state enterprises to dictate the range, quality, and cost of services available to Soviet consumers and would force the state to do a better job of satisfying demand. (Competition from the private sector, however, would not force an improvement in the performance of state enterprises in the absence of effective penalties for poor performance.)

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Despite such arguments, proposals to affirm the legality of private activity and expand its role have evoked strong opposition from officials concerned that such

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[2] The term "legal private business" is used in this assessment to denote economic operations organized and managed outside the traditional state sector of the Soviet economy (although subject to state regulation), including individual and family-run operations as well as cooperatives—partnerships organized by small groups of individuals who run the operation collectively and share the profits.

Legal Private Business in Hungary and East Germany

Over the last two decades, and especially since 1982, the Kadar regime in Hungary has shown itself more willing than its East European counterparts to promote the development of legal private business. Today several different types of such businesses combine to form an important part of the Hungarian economy:

- *A Soviet expert on the Hungarian economy estimates that individually run businesses account for roughly 60 percent of all services offered to the public and perform about 80 percent of all building repairs. Data provided by the Hungarian Central Statistical Office indicate that in 1985 such businesses generated 6.3 percent of produced national income and employed roughly 5 percent of the people working in the national economy.*

- *According to the US Embassy in Budapest, 1,500 small cooperatives, employing a quarter million people and producing everything from small computers to deodorants, accounted for 1 percent of the gross domestic product (GDP) in 1985. All cooperatives—including large agricultural farms—provided about 23 percent of produced national income in 1985.*

- *In 1982 the regime introduced a new form of private enterprise into the economy—so-called business work partnerships that blend the characteristics of small cooperatives and small owner-operated capitalistic firms. By 1985 they provided about 1.5 percent of GDP. According to the US Embassy, these partnerships—concentrated in the construction industry and allowed up to 30 employees—accounted for about half of all new housing starts in 1985.*

- *Also introduced in 1982, so called enterprise business work partnerships involve a group of people employed by state-owned firms who do some extra work—mostly in maintenance and component assembly—under contract during their off-hours but within the framework of the firm. According to the Embassy, they also accounted for roughly 1.5 percent of GDP in 1985.* 25X1

Private operators in Hungary face less severe constraints than in other East European countries. People are allowed to work full time in the legal private sector. They set their prices independently and do not face mandatory plan targets. Individually run businesses are allowed to hire up to 12 employees including up to six family members. Tax exemptions for lower levels of income—introduced in 1982—have reportedly attracted many people to the private sector. Local authorities no longer have the right to decide whether an applicant's work is "necessary" before issuing a license. 25X1

Private activity in Hungary is still closely regulated, however. According to a Soviet economist at the Institute of the Economics of the World Socialist System, 89 percent of all Hungarian craftsmen in 1983 hired no workers because of a variety of restrictions, including strict social insurance requirements and high taxes that must be paid when employees are hired. Judging by the remarks of entrepreneurs, income tax rates are still too high and credit is difficult to obtain. 25X1

In the German Democratic Republic (GDR), the Honecker regime has conducted a more modest effort to expand legal private enterprise since the mid-1970s.

In 1985, according to official statistics, individually run businesses and cooperatives accounted for 2.8 percent of produced national income, much less than that of Hungary's legal private sector. However, they provided roughly 75 percent of services performed in East Germany, according to Gerhard Weiss of the GDR State Planning Commission, the same proportion provided in Hungary by the legal private sector. In an interview in the Soviet journal Novyy Mir *in mid-1986, Weiss and Harald Blum of the Ministry of District-Managed Industry said that more than 255,000 people worked in 82,000 individually run businesses and another 159,000 worked in about 3,000 cooperatives. In total, some 5 percent of the work force is employed in legal private business.*

East Germans operating in the legal private sector enjoy some of the same advantages as do their Hungarian counterparts. They are permitted to work full-time, and individual businessmen are not subject to the state plan and are allowed to hire several employees. On the whole, however, they operate under tighter state control. Cooperatives are presented with annual plan output goals. Local authorities must approve prices set by private craftsmen. Moreover, the forms private activity may take are less varied. There is no East German equivalent, for example, to Hungary's so-called business work partnerships that allow private ownership of equipment and materials.

moves would be ideologically unpalatable and politically dangerous. Many party traditionalists, who believe in the Marxist principle that the party's monopoly of political power is based on monopoly of economic power, fear that expansion of the private sector could ultimately undermine party control by creating a commercial middle class not beholden to the regime for its social and economic position. Those traditionalists fear that an expansion of legal private activity would make it more difficult to regulate the private sector (rather than less difficult as many reformers probably believe). 25X1

As good Communists, party traditionalists also believe that state ownership represents a higher plane of economic organization; therefore, any expansion of the private sector is inherently regressive. Conservative officials publicly argue that creating additional opportunities for private individual wealth is incompatible with egalitarian socialist principles. 25X1

The Regime's Response 25X1

The Gorbachev regime has responded with a dual-track policy. It is cracking down on illegal economic activities while expanding opportunities for legal private business within limits that minimize the potential for negative consequences. 25X1

The Law on Self-Employment. The new law, which went into effect on 1 May 1987, affirms the legality of self-employment ("individual labor activity" in Soviet parlance) in a range of activities from handicrafts to medical services and legalizes certain activities that were previously prohibited, such as taxi and trucking services. Important features of the law reflect an effort to persuade underground operators and those interested in becoming engaged in private business to work legally: 25X1

- The tax rates for income earned by individual businesses—rates that Soviet economists had emphasized were "crucial" to the success of the new

Soviet Taxe Rates for Income Derived From Self-Employment Occupations [a]

	Annual Ruble Income	Marginal Tax (*percent*)		
		Old Rate	New Rate as of May 1987	Reduction in New Rate
Handicrafts and everyday services	0-840	0	0	0
	841-3,000	Up to 13	Up to 13	0
	3,001-4,000	60	20	67
	4,001-5,000	60	30	50
	5,001-6,000	65	50	23
	6,001 and above	65	65	0
Professionals [b]	0-300	0	0	0
	301-840	10-24	0	100
	841-3,000	29-47	Up to 13	Up to 72
	3,001-4,000	53	20	62
	4,001-5,000	53	30	43
	5,001-6,000	59	50	15
	6,001-7,000	59	65	−10
	7,001 and above	69	65	6

Source: Vedomosti Verkhovnogo Soveta SSSR, No. 17, 29 April 1987, pp. 231-233, and No. 43, 26 October 1983, p. 653.

[a] Taxable income is net of expenses.
[b] Includes the private practice of doctors, teachers, artists, typists, and stenographers.

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law—are lower than those existing until now for some levels of income. Income above 3,000 rubles per year from handicrafts and everyday services—and above 300 rubles per year from medical, dental, teaching, and other professional services—are taxed at reduced marginal rates (see table). For certain other activities—such as taxi driving—individuals are required to pay annual license fees in lieu of income tax.

- Self-employed individuals supposedly have complete discretion in setting prices for goods and services that they sell to the public on their own or at public markets.[3]

- Self-employment permits issued by local authorities are now valid up to five years instead of the previous one-year limit.

- Individuals are no longer restricted to their area of permanent residence in selling their goods and services.

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Authorities acknowledge, however, that other provisions of the law were designed to prevent diversion of labor from the state sector. Participation is limited to housewives, students, pensioners, and state employees

[3] If self-employed individuals choose to sell through state enterprises, they cannot charge above the state retail price for similar products or services. According to an official of Tsentrosoyuz, the state consumer cooperative network, if a self-employed individual decides to sell through the network's commission stores, he has the right to set the initial prices of goods, but the stores are entitled to lower the prices at periodic intervals if the goods remain unsold.

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working during their free time. Members of the immediate family may participate, but hiring of outside labor is strictly forbidden.

The law contains other disincentives to full-time self-employment:

- There are no provisions for private pension plans or social insurance coverage for the self-employed.
- Workers contemplating abandonment of the state sector in favor of self-employment would lose sick leave, vacation, and disability benefits.
- Persons other than those listed above who participate in the program full-time would potentially risk prosecution under the state's "antiparasite" laws, which remain in effect.

Regulations on Forming Cooperatives. Decrees approved by the USSR Council of Ministers in February 1987 create new opportunities for groups of no fewer than three persons to form profit-sharing cooperatives to engage in three types of business—consumer and food services and production of consumer goods. Cooperatives may be created under the patronage of local governments or state enterprises and contract with enterprises for material and technical resources, transportation, use of facilities, and repair services. Cooperatives have the right to independently plan production, set prices, and determine members' wages and work rules, according to the decrees. Membership in cooperatives is limited "mainly" to students, housewives, and pensioners, but cooperatives may hire employees of state enterprises for part-time work. Articles in the Soviet press indicate that in practice at least some state workers have left their jobs to work full-time for cooperatives.

Each cooperative pays a tax on its income to the local government and retains the remaining profits for production development, insurance funds, and wages.[4] During the first year, the cooperatives' tax rate is 2 to 3 percent of net income earned, 3 to 5 percent during the second year, and 10 percent thereafter. The personal income of cooperative members is subject to the same set of tax rates as that for state employees, with a top marginal rate of 13 percent.

The February decrees represent a step forward from regulations issued in October 1986 that permitted the formation of cooperatives to recycle raw materials or produce consumer goods from scrap. Those regulations—amended by the more recent decisions—were issued on an "experimental" basis, and their application extended only to limited areas of the USSR. The regulations specified tax rates that would be phased in gradually, peaking after three years at 35 percent of the cooperative's net income.

The Crackdown on "Unearned Income." The results of a crackdown on unearned income initiated in 1986 as the regime prepared legislation to increase opportunities for legal private business illustrated the difficulty of balancing liberalization and regulation. Decrees issued by the party and the government in May 1986 and implemented in July were intended to reduce corruption, theft, and tax evasion frequently associated with underground private businesses. The decrees set penalties for failure to register businesses and pay taxes.[5] New inventory control procedures were also introduced at state enterprises to curtail theft of materials and tools by workers moonlighting in the private sector. The measures also call for closer monitoring of individual income by the state. For example, citizens conducting transactions valued at more than 10,000 rubles must now submit to state authorities declarations indicating their source of income.

These steps triggered a period—described by one Soviet economist as "more than two months of administrative lunacy"—during which authorities in some regions interpreted the decrees as a mandate for an across-the-board crackdown on private activity. These

[4] According to government decrees, a cooperative's taxable income is determined by deducting from its gross income expenses for raw materials, supplies, depreciation, payment for services of outside organizations, transport costs, expenses for bank credit use, and contributions for state social insurance.

[5] For example, for failing to register and pay taxes on income earned from private activity, individuals can incur either a warning or a fine of 50 to 100 rubles.

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local party and law enforcement officials drove such activity further underground, raising prices and reducing the availability of goods and services produced privately.

Evidence clearly indicates, however, that the leadership planned for the unearned income decrees to complement, not contradict, then upcoming legislation on self-employment and cooperatives, and that it wanted to prevent the kind of backlash against legal private activity that ensued. Leonid Abalkin, director of the USSR Academy of Sciences Economics Institute, said that the unearned income decrees and the self-employment law were to be introduced in tandem, but the decrees were released first because it was easier to get officials to agree on what to forbid than on what to allow.

At the party congress in February 1986, Gorbachev qualified his endorsement of a crackdown on unearned income with the warning that such measures should not "cast a shadow on those who are receiving additional earnings through honest labor." During the summer of 1986 he balanced condemnations of those who harbor "private ownership aspirations" and neglect their contributions to the state sector with calls for a search for new forms of "individual labor activity." Gorbachev presumably hoped that by increasing penalties on underground private business activity, the unearned income decrees would provide an inducement for underground entrepreneurs to begin to operate in compliance with the law.

After widespread press reporting of how the campaign had backfired, the leadership scrambled to impose the equilibrium between liberalization and regulation it had originally sought. According to a source of the US Embassy in Moscow, the regime's first reaction was to accelerate the adoption of the law on individual labor. Articles in the Soviet press indicate that the regime also held a series of meetings with regional officials and launched a media blitz intended to curb the excesses. Top legal officials appeared repeatedly in the media to warn that the decrees should not be applied to citizens engaged in legal private business. At the same time, officials and economists sought to clarify the definition of the concept, "unearned income," arguing that it should apply only to money derived from genuine illegalities such as theft and bribe taking.

A Poor Beginning

Despite advantages of the new private business rules over previous regulations—such as the less onerous tax structure— the measures promoting the development of legal private business are being implemented with considerable difficulty: 25X1 25X1

- Speaking on behalf of the Politburo at the party plenum in June, Gorbachev acknowledged that, although many people are eager to join cooperatives or engage in self-employment, the process of expanding private economic activity is "proceeding with great difficulty and very slowly."

- According to Leonid Kostin, First Deputy Chairman of the State Committee for Labor and Social Problems, by 1 July 206,000 individuals—0.1 percent of the total population and more than 0.1 percent of the labor force—had registered for self-employment since 1 May. Included in that total may be as many as 100,000 people who were already operating legally before the new law became effective. 25X1

- According to the State Committee for Statistics, 3,000 cooperatives had been formed nationwide by 1 July. The remarks of party and state officials indicate that between 1,200 and 1,300 of these were formed in the Russian Republic. Many of those have probably not begun operating, however. Although 1,000 cooperatives had reportedly already been formally established in the Ukraine by mid-July, only 500 had opened for business.[6] 25X1

[6] Gossnab Chairman Lev Voronin said on Soviet television in late July that 630 cooperatives had been formed under the patronage of Gossnab. Embassy reporting and the Soviet press indicate that roughly one-fifth of the new cooperatives nationwide have been formed under the patronage of the state rural retail trade network, Tsentrosoyuz. Many of the cooperatives under the network have apparently been established by groups of individuals, but the remarks of a Tsentrosoyuz official suggest that some have been formed from inefficient enterprises. If these state enterprises are now functioning as true cooperatives, they could increase the availability and quality of output. If they are forced to continue operating like state enterprises and are cooperatives in name only, however, few benefits will result. 25X1

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Private Businesses: A Wide Range of Goods and Services

A variety of private businesses are springing up in those cities where local authorities are providing at least some backing for cooperatives and self-employment. Not surprisingly, the growth of private business has been especially concentrated in the service sector—where the regime's performance in satisfying consumer demand has been most deficient. Those activities attracting the largest number of individuals to the private sector include appliance, shoe, and automobile repair, tailoring, photography, cafes, hairdressing, typing, and taxi driving. Articles in the Soviet press indicate, however, that some people are exercising greater creativity in taking advantage of the new measures. Some of the other activities people have undertaken include house cleaning, home child care, auto repair instruction, home decorating, piano and organ repair, construction of parts for window frames and water faucets, ice cream manufacture, express package delivery, and tennis court construction.

- In June 1987 a Moscow city official admitted that he had expected 30,000 to 40,000 applicants for self-employment during the first month after the law became effective, but only about 10,000 people applied. According to officials in Kiev, only 500 people registered for self-employment during May, and officials in Vilnius, the Lithuanian capital, reported that 200 people applied during that month.

- According to the US Consulate in Leningrad, there has been virtually no progress in developing cooperative and self-employment activity in the city. In June US officials reported that the local press had become silent on the issue and that apart from two cooperatives that opened earlier with great fanfare, the officials were not aware of any other newly established businesses.

Dependence on Local Authorities. The regime has given broad powers to implement the new legislation to local governments, but their actions so far have been more hindrance than help. One reason for this is that local authorities are primarily concerned with accommodating the interests of state-owned and -operated enterprises whose performance is key for development of their regions and their personal success. Another is that local officials recognize that the new measures reverse the state's longstanding discouragement of legal private business, but remember other reforms, introduced with similar ballyhoo by former leaders, that were later withdrawn without harming the interests of those who refused to comply.

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Local authorities have been given responsibility for registering prospective businessmen and assisting individuals and cooperatives in finding sources of supply, tools, and transportation and in selling their products. They have the authority to permit individuals to engage in business activities beyond those specified in the self-employment law, but they may also outlaw additional activities if they are thought to "contradict society's interest." They also have the power to cut redtape to facilitate the formation of new private businesses by waiving registration requirements for types of activities they designate.

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Authorities at the Republic level have the power to determine the types of activities that require a license in lieu of income tax. Republic officials also determine the size of these fees, but many local authorities play an important role. For example, the Council of Ministers of the Russian Republic decided to allow local authorities "in exceptional cases" to increase or decrease license fees by up to 30 percent.

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While complaining at the party plenum in June about the slow development of cooperatives and self-employment, Gorbachev railed against the "lack of initiative of local organs, their lack of attention to the matter, and sometimes their reluctance to engage in it and [their imposition of] all kinds of bureaucratic obstacles." Articles in the Soviet press indicate that, because of

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the resistance of local authorities, those seeking to engage in legal private business face a variety of difficulties:

- *Obtaining permission.* Many applicants are forced to go beyond legal requirements in providing information for permits. Often they have to provide evidence of where they intend to acquire raw materials and convince authorities that they will not shirk their state sector jobs. Other applicants have been denied permission to engage in activities such as watch repair and hairdressing because authorities decided those kind of services were not needed.

- *Finding office space.* Cooperatives and individuals often have to wait months until the local government finds them office space that may then require expensive repairs for which the businesses cannot obtain credit.

- *Paying license fees.* Although in many localities the fees appear moderate, articles in the Soviet press indicate that in some areas these fees are exorbitant. An article in *Trud*, for example, reported on a TV repairman who abandoned his business in part because of an excessive license fee. In early August, *Pravda* reported on an entrepreneur in Kursk seeking to undertake auto repair work who complained about the high cost of a license.

Uncooperative Enterprises. Articles in the Soviet press indicate that many state enterprises have been unwilling to assist the development of legal private businesses. The new measures on self-employment and cooperatives encourage businesses to sign contracts with state enterprises for facilities, supplies, transportation, and equipment, but the Soviet economy has long been plagued by chronic and notorious shortages of these items. State enterprises have little incentive to provide supplies to individuals on contract, given the primacy of meeting state plans for production and sales to other state enterprises, especially if supplying individuals or cooperatives jeopardizes the enterprises' ability to meet plans and earn bonuses. In December 1986 the party and government approved decrees authorizing enterprises to sell unneeded supplies and equipment to other enterprises, cooperatives, and individuals without approval from the ministries. Private businessmen have admitted in the Soviet press, however, that they only secure their supplies by persuading enterprises to break ministerial rules that continue to prohibit the sale of such materials despite the recent decrees. 25X1

Even when enterprises have supplies that they are willing to sell, they are often not interested in handling the relatively small orders of cooperatives and the self-employed. In Baku, the chairman of a cooperative devoted to home repair and interior design complained that he was not able to find materials—such as clay, gypsum, and paint—not because they were in short supply, but because enterprises simply refused to do business with him. "We need kilograms," he said, "but they count in tons." Another cooperative chairman complained that the regional supply organs view orders from cooperatives as a nuisance, and a businessman in Krasnoyarsk was told by a state firm that, if he wanted supplies, he would have to order large quantities. 25X1

Managers of state firms sometimes do not support the development of legal private business because they fear that such businesses will lure away their workers or cause them to shirk their state jobs. In a recent article in *Ekonomicheskaya Gazeta*, a manager of a state photography shop complained that the enterprise was having difficulty attracting part-time workers because potential employees would rather register for self-employment. He also complained that employees of the firm who held licenses for self-employment were surreptitiously working for themselves on company time. 25X1 25X1

A Skeptical Public. The regime's effort to promote legal private business has also been hampered by the reluctance of citizens to register: 25X1

- People harbor fears—probably fueled by the excesses associated with the crackdown on unearned income—that the new initiatives will be short lived and that those who opt for legal activity now would suffer consequences later. One entrepreneur told a Western reporter in May, "Look at all the people

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who got rich during NEP [New Economic Policy]. A few years later they were exiled to Siberia. You never know what's going to happen here."

- Many of those who operate illegally apparently do not yet feel threatened by the crackdown on unearned income and hence have little incentive to register. Unlicensed cab drivers have told embassy officers in Moscow that the chances of being penalized were low, making it profitable to continue hauling passengers illegally. On one occasion an embassy officer and an unlicensed cab driver the officer had just hailed were pulled over by a militiaman. The driver lamely explained that he was just giving a friend a ride; the militiaman let them go on their way.

- Illegal operators apparently also fear that if they register with local authorities they will be forced to pay back taxes.

- [redacted] individuals wanting to engage in activities such as taxi driving, for which the new law requires payment of license fees in lieu of income tax, fear that the state will ultimately reverse its course and require payment of both.

- Many people are antagonistic toward the idea of others earning high personal income, especially income from private work. According to one economist, there are those who would rather "advocate equality for everyone in poverty" than increase the availability of consumer goods through private economic activity.

- According to Soviet commentators, many people still shy away from private economic activity because they believe that work outside the public sector is shameful for those with higher education. [redacted]

Signs of Support

Despite the problems hindering its efforts to encourage cooperatives and self-employment, the regime appears to have a base of support among local authorities and the public on which it can build to push its program. Some regional officials, for example, have fought hard to hasten implementation of the new measures against bureaucratic intransigence. In Moscow, a special city commission has reversed decisions of local districts and granted many individuals permission to engage in self-employment. The commission also eliminated prohibitive requirements for acquiring private taxi permits, spurring a large increase in applications. Officials in the Russian Republic's Ministry of Trade have apparently been so eager to promote the development of cooperatives under their jurisdiction that they have overstepped limits laid down in the law by allowing cooperatives to accept as full-time members many prepension-age skilled workers who leave their jobs in the state sector. A government official in a Moscow suburb acknowledged that all of the city's cooperatives "as a rule" had workers freed from state enterprises working full-time as chairmen and accountants. [redacted] 25X1

There are many factors that probably play a role in the decision of some local authorities and ministry and enterprise officials to support the new measures: 25X1

- Some may perceive it in their financial interests. Parent enterprises are allowed to count cooperative production and sales toward the fulfillment of their mandatory plans. Some also appear to welcome additional revenue from sales of unneeded supplies to cooperatives and the self-employed. (Local authorities—rather than the USSR state budget—receive income taxes paid by cooperatives.)

- In some regions those who fail to promote cooperatives and self-employment risk repercussions. In late August the Presidium of the Ukrainian Supreme Soviet criticized by name the official in charge of implementing the new measures in Vinnitsa Oblast for his "unsatisfactory" efforts. By the same token, officials who perceive high-level commitment to the new measures may well view pushing implementation as a means for getting favorable recognition from above. 25X1

Popular Reaction to Private Enterprise

The Soviet press often reports the negative reactions of citizens to legal private business. Such activity clearly offends the egalitarian instincts of many Soviet citizens. Conditioned by regime propaganda over the years to associate free market activity with a crass subordination of social welfare to selfish individual interests, many citizens are uneasy about the social implications of the course Gorbachev has chosen:

- *One city official in Moscow, outraged at the high prices charged by the vendors at a trade fair for individual craftsmen, cried, "I've worked 30 years in trade and never saw such a thing. A person pays 300 rubles a year for a license, then in only one day he sells 17 pairs of pants for a total of 120 rubles. Is this normal? I am not against self-employment, but things must be within sensible limits."*
- *One Muscovite complained to a private merchant that, "when you start selling your goods alongside a state-owned store, it hurts the state. You will become competitors with the state, and then in state stores it won't be possible to buy items."*
- *In a letter to* Izvestiya, *a man from the Ukraine warned that individual labor activity will eventually lead to social stratification, to the division of society into rich and poor. "Is this socialism?" he asks. "The press seems transported with delight at the fact that the petty bourgeois section of the population, which is fleeing social production, is beginning to get rich quick."*

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At the same time, however, other people have been quick to justify such activity. When asked whether competing with the government was a good thing, one merchant replied, "This is how it should be! We are supposed to provide competition for the government. Then everyone will begin to work as they are supposed to." A law enforcement official, defending the right of people to make high wages through legal private activity, said that salaries would eventually stabilize after private businessmen had been allowed to increase the availability of goods and services. The chairman of a would-be cooperative that had been denied a charter defended the legitimacy of his enterprise and questioned how he could be accused of trying to drain manpower from the state when his employees would only be working in their off-hours.

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- Given the trend toward increasing the accountability of party and state officials to their subordinates and the population, officials who perceive strong support for the new measures among their constituents probably see it in their interests to be viewed as backing implementation. Moreover, presumably at least some officials genuinely believe that cooperatives and self-employment have the potential to raise the population's standard of living and, thus, that such improvement is inherently worthwhile.

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The US Embassy in Moscow has reported that some citizens have reacted enthusiastically to the new measures. For example, a young doctor who spoke with embassy officials looked forward to setting up a private practice. According to Vilen Ivanov, director of the USSR Academy of Sciences Sociological Research Institute, 80 percent of the mail received after a television program about a new cooperative cafe supported new forms of private business. A poll taken in Kursk Oblast in 1986 indicated that 75 percent of the pensioners questioned and 50 percent of the women who had stopped work to care for their child wanted to work several hours a day in private business. According to sociological studies conducted in

A Soviet Entrepreneur

A Soviet entrepreneur's recent remarks to a US Embassy official in Moscow indicate the extent to which some Soviets are willing to go in pursuing opportunities for private initiative, as well as the degree to which some regime economic officials feel threatened by competition from the private sector. The businessman claimed he was the deputy director of a mining cooperative in northern Siberia that apparently operated on an experimental basis since the early 1980s. Labor productivity at the entrepreneur's firm was reportedly five times greater than the national average. He said that employees worked 12-hour shifts, the average wage was 12,000 rubles a year—almost six times the national average—and the firm provided employees with individual homes, garages, and ample recreational facilities. He claimed that his firm was being forced to shut down after a long battle with ministries presumably eager to end unfavorable comparisons between their lagging state enterprises and the highly successful cooperative. According to the businessman, the ministries had also tried to "frame" members of the cooperative with trumped-up criminal charges, but the cooperative managed to get its case put before Gorbachev, who interceded on its behalf. As a result, by July 1987 all charges had been dropped, and several legal officials had been dismissed for abuse of office.

Despite the disbanding of the mining business, the entrepreneur believed that the highly publicized bureaucratic battle left the cooperative movement in a stronger position overall. He said that he and a number of his colleagues are actively organizing a new cooperative venture that will specialize in providing fresh produce for the Moscow-Leningrad market and rural road building and construction. He claimed that he has received enthusiastic support for the new venture from party and state officials and is convinced it will succeed. "Our secret," he told the Embassy, "is that our employees are highly skilled and motivated and we will pay high wages and provide long winter vacations."

western Siberian cities, almost 27 percent of those questioned were interested in working outside their full-time job. 25X1

Regional Variations. The broad delegation of power to local officials makes it likely that the measures on cooperatives and self-employment laws will be implemented with wide regional disparities. In July an article in *Sovetskaya Rossiya* indicated that, in some regions of the Russian Republic, the number of people engaged in individual labor has already grown by as much as five or six times the number participating during 1986, while in other regions there are actually fewer people than last year engaged in such activity. Economist Abalkin told journalists that he thought that individually run businesses would not make much headway in the Russian Republic—where there is no strong tradition of such activity and public opinion is predominantly hostile to it—but would do better in other areas such as the Baltic region and the Georgian Republic. 25X1

A series of articles in *Izvestiya*, however, indicate that even in those areas more receptive to free enterprise, the battle over implementation could be tough. In April the Latvian Council of Ministers criticized the republic's financial organs for drafting measures that would discourage public interest in self-employment. Under the proposals many individuals would have been forced to travel far to register for such activity. 25X1 They would also have had to provide addresses of those enterprises from which they planned to purchase supplies. The Council ordered that the measures be reworked, and its chairman warned the financial organs against intimidating local commissions into refusing requests for self-employment registration. 25X1

By May the objections of the Council of Ministers had been accommodated, and revised measures had gone into effect. However, the Republic Ministry of Finance reserved for itself the right to determine self-employment license fees, which it set at extremely high levels. For example, those interested in driving taxis must pay fees almost three times higher than 25X1

self-employed taxi drivers in Moscow. For individuals wanting to work as tailors, licenses cost up to six times more than those for similar work in neighboring Estonia and Lithuania.

In July the Latvian Council of Ministers, aware of the negative effect that the high fees were having on the numbers of individuals registering for self-employment, gave the Ministry of Finance two weeks to propose new lower rates for the most distorted fees and until 15 October for others. The Council's chairman warned ministry, enterprise, and local government officials that they would be held personally responsible for development of individual labor.

Growing Leadership Commitment

During 1986 and early 1987 Gorbachev seemed to lack the Politburo's strong backing for the expansion of legal private business opportunities, but in recent months several of his colleagues have joined him in vocally promoting the new measures. Perhaps spurred by the slow start, the leadership is evidently prepared to push harder for effective implementation, even if some of its members remain wary of going too far.

During his trip to the Baltic region in February, while other leaders remained virtually silent on private business, Gorbachev vigorously defended the expansion of cooperatives and the legalization of self-employment opportunities. He argued that the "foundations" of the socialized economy would remain intact, even if 5 to 7 percent were "broken off" by self-employment.[7] By contrast, according to a source of the US Embassy in Moscow, "Second Secretary" Yegor Ligachev vigorously resisted the law on self-employment on ideological grounds and managed to delay its adoption. Moreover, Ligachev's public emphasis on the need to strengthen discipline and crack down on corruption suggests he was primarily interested in ensuring implementation of the decrees on unearned income. 25X1

Politburo member Geydar Aliyev and candidate member Vladimir Dolgikh also opposed the expansion of legal private enterprise. 25X1 25X1

In recent months, however, Ligachev's influence has been diluted as a result of an increase in the number of senior secretaries—members of the Secretariat who hold full membership in the Politburo—decided at the Central Committee plenum in June. Aliyev has only recently reassumed a public role after a long illness and is widely reported to be in political decline. During this same period, Gorbachev has become even more vocal in promoting legal private business, and, more important, several other Politburo members have joined him, apparently leaving opponents increasingly overmatched: 25X1

- At the party plenum in June, Gorbachev made only passing reference to the struggle against unearned income, argued forcefully that "our own experience and that of other socialist countries attests to the usefulness of and need for skillful use of [cooperatives and self-employment]," and lashed out against those "who see cooperative and individual labor activity as virtually a restoration of private enterprise." 25X1

- At the Supreme Soviet session, Premier Nikolay Ryzhkov omitted reference to the crackdown on unearned income, demanded that local organs make fuller use of cooperatives and self-employment, and said that "there must be tens and hundreds of times more cooperatives, and their contribution must be made more tangible." In an April speech he stressed that cooperatives would become a "substantial complement" to the state consumer sector.

- In a May speech Vitaliy Vorotnikov, Chairman of the Russian Republic's Council of Ministers, emphasized that "cooperatives have considerable potential" and that "the main thing is not to make the new system overregimented, not to hem it in like a

[7] Gorbachev has also attempted to legitimize an expansion of the size of the legal private sector by promoting favorable discussion of the NEP developed under Lenin in the 1920s. During the NEP period, factory production remained overwhelmingly in state hands, but private business dominated small-scale and handicrafts industry, accounting for over 75 percent of its total output and over 95 percent of its total employment. 25X1

bear in its den, so that if it does come out it is immediately speared. It must be given a chance to develop. It must be strengthened."

- In a speech in Tajikistan in April—two months before his promotion to full Politburo membership—Aleksandr Yakovlev, party secretary sharing responsibility for ideology and culture, said that past "disregard of Lenin's ideas on the cooperative system led to a narrowing of socialism's economic potential." He also pointed out that "the definition of self-employment as alien squeezed out of production a considerable number of people who were capable of working and, furthermore, of working in areas where the state's activities did not extend." In May in an article in *Kommunist*, the party's most authoritative journal, he argued that the "cooperative may contribute to the . . . effective functioning of the socialist market, then why raise ideological and practical obstacles to its development?"

Apparently concerned that other leaders have underestimated the dangers of private enterprise, Ligachev has increasingly stressed the need for strict controls. During a speech to party officials in Tbilisi, Georgia, in June 1987, a month after the law on this activity had come into effect, he cautioned that the party's encouragement of self-employment "has nothing to do with unbridled privately owned enterprise" and emphasized that party and state organs "must keep a firm grip on the levers of economic management . . . it is easier to lose that grip than to regain it later." At the same time, he may be getting increasing pressure to back publicly what is now official policy. In the July issue of *Problemy Mira I Sotsializma*, for example, he acknowledged that cooperatives were only recently being restored to their rightful position after long neglect and that "misconceptions and prejudices about the role of individual labor activity were being overcome."

Followup Measures. Regardless of whatever lingering doubts Ligachev or others might have, the leadership is going forward with additional measures to promote legal private business. At a 24 September meeting—presumably chaired by Ligachev while Gorbachev was on vacation—the Politburo approved the establishment of cooperative shops to sell goods produced by cooperatives and by people engaged in individual labor activity. It also authorized state retail stores and consumer cooperative outlets to form special shops that sell privately produced merchandise.

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In addition, the regime is taking concrete steps to address problems of implementation. A provision was added to the final version of the law on enterprises enacted by the Supreme Soviet calling on them to assist self-employed individuals and cooperatives who work with the enterprises on a contract basis. The guidelines for comprehensive reform approved at the Central Committee plenum mandate that "cooperatives and self-employment be encouraged in every way." Specifically, they call for the preparation of measures that would revise or abrogate instructions of central administrative bodies that weaken legislation on cooperatives and self-employment.[8] Under such measures, for example, enterprises would no longer be prohibited by their ministries from selling unneeded equipment and supplies to cooperatives and individuals. Presumably, it would also become more difficult for local authorities to complicate the registration process for businesses. The guidelines also order the Ministry of Finance and its regional organs to prepare a package of measures that apparently is intended to facilitate the acquisition of credit by legal private businesses. In addition, Ligachev confirmed in his July article that preparation of a law on cooperatives was under way, probably intended to give greater legal underpinning to the cooperative movement and to establish legal sanctions against authorities who obstruct it.

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Outlook

The trouble-plagued beginning of the regime's efforts to promote cooperatives and self-employment suggests that goods and services from legal private business in

[8] In an interview on Soviet radio in June, outspoken reform advocate Fedor Burlatskiy said that one of the major problems plaguing the development of legal private business was the lack of legal safeguards preventing administrative bodies from issuing instructions that contradict the laws on self-employment and cooperatives. In an interview with a top legal official in April, an *Izvestiya* journalist claimed that several USSR ministries had just passed a number of such instructions intended to weaken the law on self-employment.

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1987 will represent only a tiny fraction of that provided by the state sector and will do little, at least over the short term, to make up for shortfalls in availability and quality of goods and services. Projections, based on the very limited data available, suggest that, if the early pace continues, probably no more than 500,000 people will register for self-employment during 1987. According to the State Committee for Statistics, by the end of September 80,000 people had joined cooperatives, suggesting that, by the end of the year, cooperatives nationwide may employ approximately 120,000 people.

Although it is unclear how far the regime intends to develop legal private business, Gorbachev and a senior economic adviser have publicly given optimistic long-term projections. In February 1987 during his visit to the Baltic region, Gorbachev indicated that perhaps 5 to 7 percent of national income would be produced by individually run businesses. In late 1986 economist Abalkin predicted that cooperatives would account for between 10 and 12 percent of national income within the next decade.[9] Perhaps given the slow implementation of the new measures thus far, however, official sources have been more restrained lately in their projections. According to an August *Izvestiya* article, it is envisaged that self-employment eventually will contribute 0.5 percent of national income. At the Supreme Soviet session in June, Premier Ryzhkov said that it was planned for cooperatives within the next few years to provide a minimum of 3 to 5 percent of the total volume of services and public catering.[10]

Although projections suggest that, during 1987, more people will register for self-employment than for cooperatives, evidence indicates that over the long haul the regime will meet with greater success in developing cooperatives. Officials will tend to be more receptive toward them not only because they have their production or sales counted toward the plan fulfillment of their patron enterprises, but also because they are seen as ideologically superior to individually run businesses and more in harmony with Russian traditions. Those interested in engaging in legal private business may choose cooperatives because of certain advantages over individual businesses—such as lower tax rates, priority in allocation of facilities and supplies, and assistance by enterprises in finding such items and selling their products. Perhaps reflecting its awareness that gains in the development of cooperatives can be made with less difficulty, the leadership gives them somewhat greater attention in its public statements. According to a source of the US Embassy in Moscow, the leadership wants wider press coverage and support for cooperatives than for self-employment.

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For Gorbachev to reap the kind of gains that he expects from cooperatives and self-employment, he will have to loosen the restrictions on eligibility and provide people with additional incentives to become involved in such activities. Some economists and officials clearly want the leadership to go further to encourage legal private business now:

- In the May-June issue of *Sotsiologicheskiye Issledovaniye*, Gennadiy Batygin of the Sociological Research Institute argued that the tax reductions approved by the government do not go far enough and that, for the first one or two years of operation, income earned by private businessmen should be tax exempt.

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- In the January-February issue of the same journal, economist Svetlana Glinkina of the Institute of the Economics of the World Socialist System wrote favorably of Hungary's 1982 decision stripping local authorities of the right to decide whether an individual's work was necessary before allowing him to register for self-employment. She also praised Hungary's establishment in the 1970s of the All-Hungary Council of Small Craftsmen, which has proved successful in representing large numbers of individuals in selling their products and in purchasing their supplies.

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[9] Abalkin may have been including existing forms of cooperatives in his estimate such as housing cooperatives, collective farms, and the consumer cooperative trade network.

[10] To the extent that individually run businesses and cooperatives become a substitute for illegal activity, the net gain to the economy will be less than any of the predictions suggest.

- Geliy Shmelev, section chief at the Economics of the World Socialist System Institute, called for granting paid vacation, sick leave, pensions, and other benefits to private workers.

- During the Supreme Soviet debate on the self-employment law, a regional party leader argued that more should be done to provide private-sector workers the same status and prestige as state workers.

Continuing poor performance by the state sectors that produce consumer goods and provide services would probably act as a catalyst to improve incentives for participation in private economic activity. Many officials who supported the recent measures, largely for their relatively low costs, would undoubtedly prefer that approach to a diversion of scarce investment resources. The Consumer Goods and Services Program announced in late 1985 sets ambitious targets for increased output of goods and services by the state sector. It is doubtful, however, that the investment resources needed to meet the program's goals will be made available, given the regime's commitments to defense and the demands of the modernization program in heavy industry.

Along with improving incentives, the regime will ultimately have to follow through with ambitious plans outlined at the Central Committee plenum in June for introducing comprehensive economic reform by the beginning of the 13th Five-Year Plan in 1991. The introduction of far-reaching reforms in Hungary and China spurred the growth of legal private business in those countries. If the formidable obstacles to implementation are overcome in the Soviet case, detailed central control over economic activity would be reduced, and state enterprises would be transformed into profit seekers that compete for customers. Only if the state is no longer making claims on much of their output will enterprises stop hoarding supplies and be more willing to meet the needs of cooperatives and individually run businesses. Moreover, a greater emphasis on the profit motive throughout the economy would lessen public hostility toward legal private activity and sensitize local authorities and state enterprises to the benefits that derive from the comparative advantages of small, flexible private businesses in the production of many goods and services. 25X1

In the meantime, the regime will probably use the Central Committee plenum's endorsement of cooperatives and self-employment to hold regional officials accountable for obstruction. It appears committed to introducing legislation intended to smooth implementation—such as measures abrogating ministerial instructions contradicting the law on self-employment. The leadership will also want to encourage media publicity for success stories and exposure of obstacles preventing the expansion of private business. 25X1

Perhaps as important as persistently pushing the measures on cooperatives and self-employment will be the leadership's willingness and ability to clamp down more effectively on illegal operators. As long as opportunities are more lucrative and largely risk free outside of the law, few Soviet entrepreneurs will have much incentive to operate legally. These tactics fall short of the changes needed to make legal private economic activity flourish, but they would help build the credibility of the new measures among local authorities and the population, effect some gain in consumer satisfaction, and give Gorbachev and his allies leverage needed to push for further expansion of legal private business. 25X1 25X1

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